Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION

In the Matter of)
)
Price Cap Performance Review) CC Docket No. 94-1
for Local Exchange Carriers;)
Treatment of Video Dialtone Services)
Under Price Cap Regulation)

NYNEX COMMENTS

The NYNEX Telephone Companies[1] ("NYNEX") file these Comments in response to the Commission's Third Further Notice of Proposed Rulemaking ("3d FNPRM") released September 21, 1995, in the above-captioned matter.

I. INTRODUCTION AND NYNEX POSITION

The Commission's Second Report and Order ("2d R&O") in this matter (which accompanies the 3d FNPRM) requires LECs to segregate video dialtone ("VDT") costs and revenues from those for telephone service for purposes of the sharing and low-end adjustment mechanisms once the LEC's provision of VDT exceeds a de minimis threshold.[2] The 3d FNPRM seeks comment on the specific level for the de minimis threshold as well as on procedures for allocating costs to the VDT basket if and when a LEC exceeds the threshold.[3]

It is NYNEX's position that the threshold should be set no lower than the amount of dedicated interstate VDT investment that would reduce the LEC overall interstate rate of

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1 The NYNEX Telephone Companies are New England Telephone and Telegraph Company and New York Telephone Company.

2 2d R&O at ¶ 1.

3 3d FNPRM at ¶¶ 39-42.

return by 25 basis points. If and when that threshold is reached, costs should be apportioned to the VDT basket using the approach in the FCC's price cap new services test, i.e. apportion no more than VDT direct costs plus allocated overhead costs reflected in pricing.

II. THE THRESHOLD FOR REMOVING VDT FROM SHARING AND LOW-END ADJUSTMENT CALCULATIONS SHOULD BE NO LOWER THAN THE AMOUNT OF DEDICATED VDT INVESTMENT THAT WOULD REDUCE LEC OVERALL RATE OF RETURN BY 25 BASIS POINTS

By way of background, in the VDT Recon. Order,[4] the Commission directed LECs to establish subsidiary accounting records consistent with the Part 32 Uniform System of Accounts in order to segregate VDT-related costs and revenues from those for telephone service. The Commission also required LECs authorized to provide VDT to file summaries of these subsidiary accounting records with the Commission on a quarterly basis. The Commission delegated authority to the Chief, Common Carrier Bureau to determine the content and format of the VDT subsidiary records and quarterly reports.[5]

The Commission indicates in its 2d R&O that in order to address its "concern regarding the possibility of cross-subsidization of LEC video dialtone service," it will exclude VDT costs and revenues from the calculation of LEC interstate earnings for sharing and low-end adjustment purposes once VDT costs exceed a certain threshold.[6] The

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[4] Telephone Company - Cable Television Cross-Ownership Rules, CC Docket No. 87-266, 10 FCC Rcd. 244, ¶ 173 (1994).

[5] Id. On April 3, 1995, the Bureau's Accounting and Audits Division issued RAO Letter 25 (10 FCC Rcd. 6008), which sets forth specific guidelines on the requirements for accounting classifications, subsidiary records, and amendments to cost allocation manuals for LECs that receive Section 214 authorization to provide VDT. On September 29, 1995, the Chief, Common Carrier Bureau released a Memorandum Opinion and Order adopting and implementing requirements for an ARMIS quarterly report that will contain wholly dedicated and shared VDT costs captured in subsidiary accounting records; and an expanded fourth quarter ARMIS report that will contain VDT cost and revenue data disaggregated by regulated and nonregulated classifications and by jurisdictional categories. Reporting Requirements On Video Dialtone Costs And Jurisdictional Separations For Local Exchange Carriers Offering Video Dialtone Services, DA 95-2036, AAD No. 95-59 ("AAD 95-59 Order").

[6] 2d R&O at ¶ 35.

Commission proposes to base that threshold on the data carriers are required to submit under RAO 25:

> Using the RAO Letter 25 data, the threshold could be set at the amount of dedicated video dialtone investment that would reduce the LEC overall rate of return by a specified amount, such [as] 10 or 25 basis points, for example.[7]

NYNEX agrees with the Commission's suggestion regarding use of 25 basis points. That approach to determining the threshold will effectively balance the Commission's public policy objectives of avoiding unnecessary administrative burdens and ensuring that potentially low initial VDT earnings will not significantly reduce overall LEC earnings which would potentially reduce sharing obligations.[8]

Use of dedicated VDT investment in determining the threshold is reasonable since such investment amounts under RAO 25 will be readily obtainable with a minimum of potential controversy from the LEC's ARMIS fourth quarter report. In addition, use of 25 basis points in calculating the threshold is supported by FCC precedent concerning the rate of return buffer zone for triggering earnings refund obligations. Under previous rules, the Commission prescribed an enforcement buffer of 25 basis points above the authorized rate of return, such that earnings within the buffer were deemed not significant enough to trigger refund obligations.[9] Indeed, prior to 1987 the FCC applied an enforcement buffer of 50 basis points.[10]

III. ONCE THE THRESHOLD IS REACHED, COSTS SHOULD BE APPORTIONED TO THE VDT BASKET USING THE APPROACH IN THE COMMISSION'S PRICE CAP NEW SERVICES TEST

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[7] 3d FNPRM at ¶¶ 39-40.

[8] 2d R&O at ¶ 35.

[9] See MCI Telecommunications Corp. v. FCC, No. 93-1191, Slip Opinion at p. 6 (D.C. Cir. Aug. 1, 1995) (discussing regulatory history of FCC rate of return prescriptions and refund rules).

[10] See id. at p. 4

The Commission invites comment on an approach for apportioning costs to the VDT basket for purposes of sharing and low-end adjustments once the threshold has been passed in the case of LECs that select an X-factor with sharing and low-end adjustments for telephony. The Commission suggests that it "could allocate costs to the video dialtone basket using the approach in the new services test applied in the tariff review process for setting video dialtone rates ... ."[11]

NYNEX agrees with this suggestion and believes two main policy goals should guide the Commission's decision on this issue. First, the purpose of removing VDT costs and revenue from sharing/low-end adjustment calculations is to guard against cross-subsidy of VDT.[12] Second, the Commission should provide for the use of existing data sources as opposed to imposing new regulatory requirements and administrative burdens.

NYNEX offers a proposal here which meets these policy goals through reliance upon the Commission's existing price cap new services test and the required ARMIS quarterly reports on VDT.[13] The appropriate cost amounts to exclude from the sharing/low end adjustment mechanisms are all direct costs wholly dedicated to VDT plus the VDT portion of shared investment and associated plant related expenses. To the extent that shared overheads are reflected in VDT prices, they may also be removed to calculate the interstate access rate of return.

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11 3d FNPRM at ¶ 41.

12 2d R&O at ¶ 35.

13 We offered such a proposal in our preceding filings in this matter. See NYNEX Comments filed April 17, 1995, pp. 9-10; NYNEX Reply Comments filed May 17, 1995, pp. 8-9.

The Commission has already held that its price cap new services test applies to VDT. Under that test, initial VDT tariff rates must cover direct costs[14] and a reasonable allocation of overhead costs.[15] The Commission expressed the desire that VDT be a successful service contributing to the recovery of common costs. To this end, the Commission indicated that the price cap new service rules must not "saddle video dialtone with an unreasonable proportion of overheads and other common costs."[16]

It is important to recognize that as long as VDT rates cover incremental costs, there is no cross-subsidy of VDT, i.e. ratepayers for other services are not bearing any costs incurred as a result of VDT.[17] By definition, costs other than VDT incremental costs would exist in any case, i.e. independent of VDT, and there is no need for VDT rates to bear those non-incremental costs to preclude cross-subsidy.

As described above, the FCC has already made very clear that VDT rates under the price cap new services test must cover all VDT direct costs, which include all VDT incremental costs.[18] Indeed, by requiring that such VDT rates also cover allocated non-incremental costs, the FCC has more than ensured against cross-subsidy of VDT. To the same effect, use of the approach in the price cap new services test to calculate VDT costs

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14 The Commission provided specific guidance in its VDT Recon. Order that VDT direct costs include "the costs and cost components associated with the primary plant investment that is used to provide the service," as well as a "reasonable allocation of other costs that are associated with shared plant used to provide video dialtone and other services ... . [W]e do not anticipate accepting a 0% allocation of the common costs of shared plant as reasonable." Id. at ¶¶ 217-18. Besides such plant account-related costs, the Commission directed carriers "to treat costs in other accounts as direct costs if those costs are reasonably identifiable as incremental costs of video dialtone service." Id. at ¶ 219. See also RAO 25.

15 The Commission indicated that "all costs not treated as direct costs are classified as overheads" and that it "would not anticipate accepting a 0% allocation of overhead as reasonable." VDT Recon. Order at ¶ 220.

16 Id.

17 See Separation Of Costs, CC Docket No. 86-111, 2 FCC Rcd. 1298, ¶ 109, notes 105 & 214.

18 VDT Recon. Order at ¶¶ 217-19.

and revenue for removal from interstate regulated earnings calculations would more than ensure that the sharing and low-end adjustment mechanisms not produce cross-subsidy of VDT.[19]

These VDT cost and revenue amounts can be obtained pursuant to existing requirements and filings, i.e. the ARMIS fourth quarter report of VDT costs and revenue determined consistent with the VDT Recon. Order, RAO 25 and the Bureau's AAD 95-59 Order.[20] LEC VDT tariff filings following the price cap new services test will be on file with the Commission, containing full cost support delineating all direct costs and allocated overheads.

Any issues on the appropriateness of LECs' identification of VDT costs and revenue can be adequately resolved in the tariff review process and Commission review of ARMIS reports. Notably, since VDT is a nascent service which may be offered by carriers utilizing a variety of service features and network architectures, carriers may employ different cost allocation methodologies respecting VDT shared costs and overheads.[21] Given this reasonable potential diversity, the Commission has identified the tariff review

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19 If a fully distributed cost allocation were used to remove VDT costs prior to calculation of interstate rate of return for purposes of sharing/low end adjustment mechanisms, more costs would be removed than would be covered under the Commission's pricing rules. There is no basis for apportioning more costs than required under the Commission's pricing rules which already go beyond preventing cross-subsidy. In fact, to do so may be viewed as granting an undue advantage to access ratepayers at the expense of emerging VDT services.

20 The Commission states that under the new services approach, "if somewhat different cost allocation methodologies are used for a single LEC due, for example, to differences in technology for various video dialtone systems, we propose to weight the application of the different cost allocation methodologies in some manner." 3d FNPRM at ¶ 41. NYNEX believes that such a weighting approach will not be necessary inasmuch as the VDT ARMIS quarterly reports will capture in an additive manner the VDT costs for a LEC's discrete VDT systems.

21 See VDT Recon. Order at ¶ 196; Video Dialtone Order, CC Docket No. 87-266, 7 FCC Rcd. 5781, ¶¶ 13, 34, 103, n.104; Bell Atlantic Telephone Companies Transmittal Nos. 741, 786, Order released June 9, 1995, ¶ 16 (CCB); 3d FNPRM at ¶ 41.

process for individual LECs as the appropriate vehicle for specifically addressing such matters.[22]

The use of these existing regulatory processes will help conserve administrative effort of the Commission and parties in attaining the Commission's policy goals. Overall, as the Commission previously found, the "existing rules adequately protect consumers against improper cross-subsidy and anti-competitive activity."[23]

IV. CONCLUSION

For the reasons stated, if a LEC's video dialtone dedicated investment corresponds to a threshold no lower than 25 basis points of interstate return, then the LEC should remove VDT costs and revenue from sharing/low end adjustment calculations. VDT costs to be removed should be determined using the approach in the FCC's price cap new services test, i.e. remove no more than VDT direct costs and allocated overheads reflected in pricing.

Respectfully submitted,

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[22] VDT Recon. Order at ¶ 214; Bell Atlantic Telephone Companies, supra, ¶¶ 15-16.

[23] VDT Recon. Order at ¶ 166.

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing **NYNEX COMMENTS** was served on the party listed below, this 27th day of October, 1995, by hand.

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